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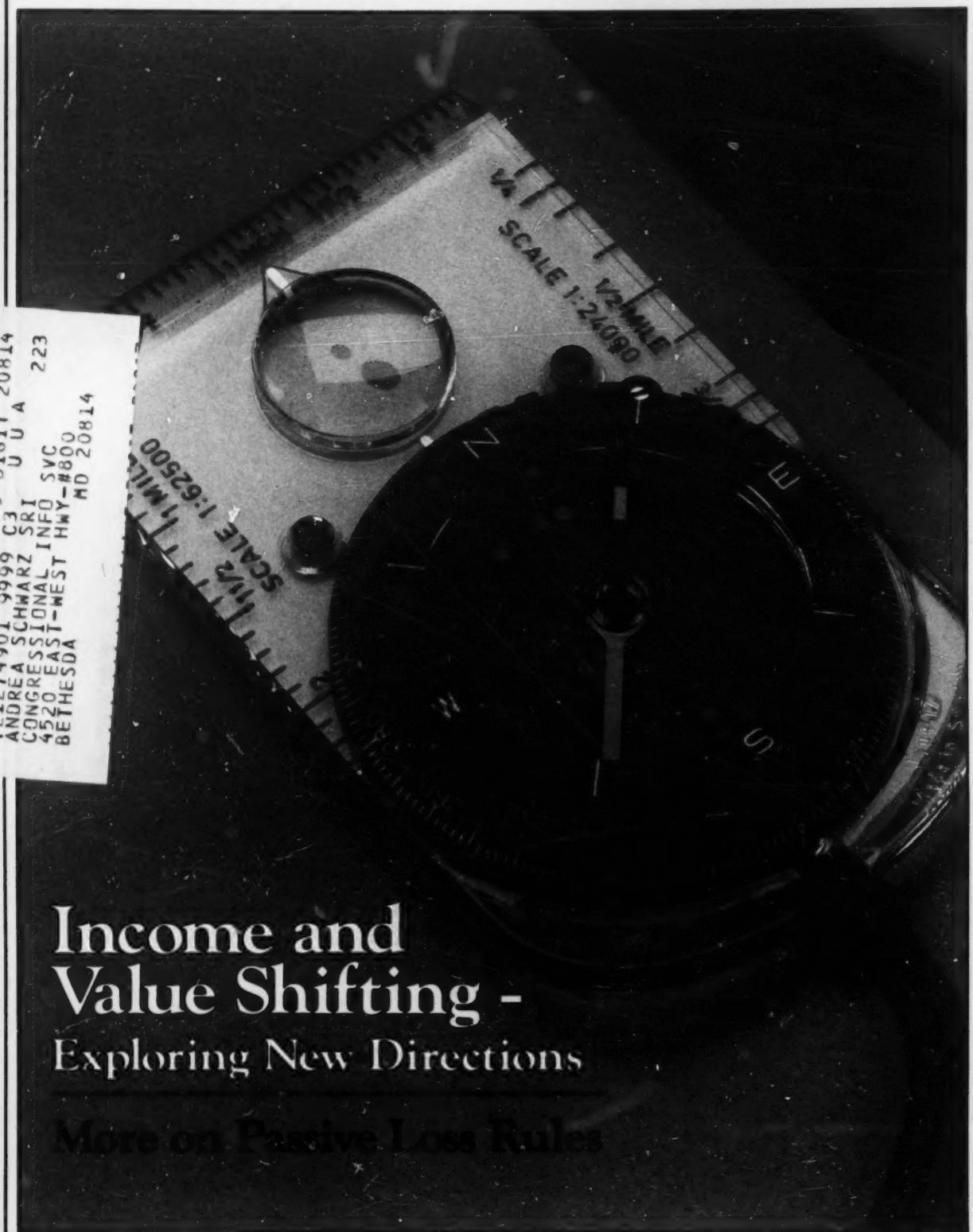

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Income and Value Shifting - Exploring New Directions

More on Passive Loss Rules

TRUSTS & ESTATES

Volume 126, No.10 OCTOBER 1987

Estate Planning and Administration Since 1904

INCOME AND VALUE SHIFTING — NEW DIRECTIONS

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COVER

This month we examine the new directions in income and value shifting which fiduciaries and financial planners can follow when building a comprehensive financial plan for clients. Cover photo courtesy of the Silva Division of Johnson Camping, Inc. Binghamton, New York.

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Commentary

Exploring New Territory

No matter which direction an explorer travels, magnetic north always remains constant. It is much the same for fiduciaries. There are many avenues and paths to pursue when seeking to lay out the best financial course for a client, but magnetic north, the fiduciary's responsibility to prudently supervise and manage his or her client's assets, always remains constant.

With this goal in mind, we examine in this issue some of the new directions in income and value shifting which fiduciaries and financial planners can follow when building a comprehensive financial plan for their clients.

In their article, "Income and Value Shifting: New Problems, Approaches and Techniques After TRA '86," Howard M. McCue III and Daniel W. Luther of Mayer, Brown & Platt in Chicago report that the Act has had "significant adverse impact" on many of the techniques for income and value shifting which were popular under the old law.

The authors survey some of the old and new approaches and techniques available and conclude that, while some old techniques are no longer viable, some others have continued utility and some new techniques require consideration. According to the authors, "Income shifting may become less attractive to many, but value shifting is alive and well."

An "illusionary and disappearing" lever is examined this month by David M. Donaldson of Ropes & Gray in Boston. His article on Generation-Skipping Transfer Tax and Charitable Lead Trusts states, "When one takes the time value of money into account at a reasonable discount rate, the 1986 Generation-Skipping Transfer Tax, as originally enacted, did not provide an opportunity to leverage the GSTT exclusion; in most cases, the donor would be wasting the exclusion by combining it with a charitable lead trust.

The author states that the Technical Corrections Bill, which is now pending in Congress, would only make matters worse in that it will have the effect of making charitable lead trusts, which terminate in favor of grandchildren uneconomic from a tax standpoint.

Not only must fiduciaries be prudent when dealing with their client's assets, they must also be cautious, as evidenced by the recent barrage of claims, court decisions and out-of-court settlements resulting in enormous damages against various institutions for alleged misconduct. This growth in fiduciary liability claims is examined this month by Roy M. Adams and Carter Howard of Schiff Hardin & Waite in Chicago.

As stated in the article, "These decisions evidence a growing trend of courts and juries to hold corporate fiduciaries to a higher standard of conduct, and to penalize them severely if their conduct has fallen short."

The authors give us a checklist to anticipate and avoid later conflicts and to highlight potential problem areas. □

Law & Life Insurance

The growing prospect of increased life insurance sales by depository institutions raises questions on differing life insurance producers

By **BURKE A. CHRISTENSEN**
Vice President and General Counsel
American Society of Chartered Life Underwriters
Bryn Mawr, Pa.

Recently published research regarding the sale of insurance by banks or savings and loans will be instructive to the banking industry in general.[1]

A survey of insurance sales of depository institutions was sent to 100 of the largest banks and 100 of the largest savings and loan associations in the United States. The amount of assets was the factor used to measure size. Thirty four useable responses were obtained from the banks surveyed and 41 useable responses were obtained from the savings and loan associations.

Tables 1 and 2 illustrate the size and location of the respondents. As shown, the majority of the bank respondents were Eastern or Midwestern institutions with less than 10 billion dollars in assets. For the savings and loan respondents, over 90 percent had less than 10 billion dollars in assets, but the geographical distribution was more balanced.

The 200 financial institutions were asked a series of five questions about their present or anticipated activities with regard to four kinds of insurance: Life, Property, Liability, and Health. Tables 3 and 4 display a categorized summary of the information obtained from the respondents.[2]

It is interesting to note that sales of all types of insurance by banks are much more closely associated with the granting of credit than are such sales by the savings and loan institutions. On the other hand, the savings and loan associations seem much more ready to move into insurance sales related to the marketing of financial planning services than do the banks. This is somewhat surprising since one generally associates such financial planning services with banks and bank trust departments rather than with a savings and loan association.

The growing prospect of increased life insurance sales by depository institutions raises a question about the role

Table 1

Size of Assets*

	Banks	S&Ls
Less than 5 billion dollars	32.4% (11)	73.1% (30)
5-10 billion dollars	47.1% (16)	17.1% (7)
11-20 billion dollars	8.8% (3)	4.9% (2)
21-30 billion dollars	2.9% (1)	4.9% (2)
31-40 billion dollars	0.0% (0)	0.0% (0)
Greater than 40 billion dollars	8.8% (3)	0.0% (0)
*Frequencies in parentheses	n = 34	n = 41

Table 2

Geographical Location*

	Banks	S&Ls
East	44.1% (15)	17.1% (7)
Midwest	23.5% (8)	39.0% (16)
South	8.8% (3)	14.6% (6)
Southwest	8.8% (3)	7.3% (3)
West	14.7% (5)	22.0% (9)
*Frequencies in parentheses	n = 34	n = 41

of the the differing kinds of professional life insurance producers.

Life insurance policies are no longer easy concepts to understand, explain or compare. Although the unbundling of the various internal policy factors such as interest crediting rates, mortality charges and expense loading charges creates the appearance of an easy comparison based upon a clear understanding of those factors, quite the opposite is actually the case.[3] The producer making the comparison must be sophisticated enough to discover the assumptions upon which the life insurance policy series, and the illustrations which market it, are based.

For example, in determining the credited rate of interest on a policy, does the insurer measure the earnings based upon the "new money" rate or the "portfolio" rate? The portfolio rate concept accumulates a large group of years or a group of products and credits interest to that group of products or the policies from that group of years based upon the average return for the group.

Depending upon whether interest rates are falling or rising one method will usually out perform the other. Similar issues arise with regard to mortality charges and loading expenses.

The new money rate concept segregates each year's investments as a separately identified portfolio and credits interest to the related products group based upon that year's portfolio.

Depending upon whether interest rates are falling or rising one method will usually out perform the other. Similar issues arise with regard to mortality charges and loading expenses. The quality of the guarantees in the policy contract if the illustrated assumptions are not met can also be of significant importance. The consumer should also be advised with regard to the quality of the company.

Professional Training Needed

The question to be asked is whether such sophisticated presentations and comparisons can be made without professional insurance training and education. Without such training can a bank employee perform the insurance marketing equivalent of due diligence

Table 3

Insurance Sales Results (frequencies)*

	Life		Property		Liability		Health	
	Banks	S&Ls	Banks	S&Ls	Banks	S&Ls	Banks	S&Ls
1. Do you currently sell?	28(6)	35(6)	13(21)	28(13)	11(23)	19(22)	19(15)	19(22)
2. If yes, with loans?	23(5)	25(10)	9(4)	16(12)	8(3)	9(10)	15(4)	10(9)
3. Sell or contemplate with financial planning services?	20(14)	31(10)	13(21)	21(20)	11(23)	17(24)	9(25)	14(27)
4. Sell or contemplate as a separate product line?	20(14)	31(10)	16(18)	28(13)	13(21)	23(18)	14(20)	17(24)
5. If no, why not?								
a. Legal restrictions	7	5	9	5	11	2	7	3
b. Current corporate policy	6	5	8	8	10	14	8	17
c. Other	1	0	1	0	0	2	5	4
*"No" answer frequency in parentheses	n = 34	n = 41	n = 34	n = 41	n = 34	n = 41	n = 34	n = 41

Table 4

Insurance Sales Results (percentages)

	Life		Property		Liability		Health	
	Banks	S&Ls	Banks	S&Ls	Banks	S&Ls	Banks	S&Ls
1. Do you currently sell?	82.4%	85.4%	38.2%	68.3%	32.3%	46.3%	55.9%	46.3%
2. If yes, with loans?	82.1%	71.4%	69.2%	57.1%	72.7%	47.4%	78.9%	52.6%
3. Sell or contemplate with financial planning services?	58.8%	75.6%	38.2%	51.2%	32.4%	41.5%	26.5%	34.1%
4. Sell or contemplate as separate product line?	58.8%	75.6%	47.1%	68.3%	38.2%	56.1%	41.2%	41.5%
5. If no, why not?								
a. Legal restrictions	50.0%	50.0%	50.0%	38.5%	52.4%	11.1%	35.0%	12.5%
b. Current corporate policy	42.9%	50.0%	44.4%	61.5%	47.6%	77.8%	40.0%	70.8%
c. Other	7.1%	0.0%	5.6%	0.0%	0.0%	11.1%	25.0%	16.7%

on behalf of the bank's insurance customer?

Norris W. Clark, Chief of the Financial Analysis Division of the California State Insurance Department suggests that an ever-increasing level of sophisticated knowledge about the products sold and the carriers that sell them is an obligation of the producer.[4]

Clark believes that producers should know and understand the financial disclosure statements which an insurance company must file with state regulators. He has urged those who market life insurance to be familiar with a carrier's investment mix, its historical profitability, reinsurance arrangements and leverage.

Substantial professional insurance knowledge is required to make an analysis of this information meaningful to the producer and the customer. For example, Clark notes that "unsatisfactory profitability is not always bad because rapidly growing companies produce statutory losses. If the business being written is adequately priced and well underwritten, it can be expected to be profitable in the long run."[5]

The level of knowledge and skill required by implication in this statement is a high standard to meet. How many non-professional life underwriters are capable of determining whether a block of life insurance is "adequately priced and well written?" Without substantial disclosure by the life insurance carriers to one who is sophisticated enough to ask the right questions, how can anyone make such a determination?

It is obvious that a bank or savings and loan which contemplates entering the insurance business should be prepared to educate those who will market its products. □

Burke A. Christensen, J. D., is vice president for corporate and member affairs and general counsel of the American Society of Chartered Life Underwriters, Bryn Mawr, Pa. He also maintains a private law practice in Pennsylvania.

FOOTNOTES

1. James R. Webb, PhD and David N. Hawk, DBA, CPCU, CLU, ChFC, "Insurance Sales of Depository Institutions: A Survey." *The Journal of the American Society of CLU & ChFC*, Vol. XLI, No. 4 (July 1987), page 88.)
2. Charts reprinted, with permission, from the Journal of the American Society of CLU & ChFC, Vol. XLI, No. 4 (July 1987). Copyright 1987 by the American Society of CLU & ChFC, 270 Bryn Mawr Avenue, Bryn Mawr, Pa. 19010.
3. See Edward P. Mohoric, FSA and Paul Silberberg, JD, "Life Insurance Illustrations: Use and Abuse", *The Journal of the American Society of CLU & ChFC*, Vol. XLI, No. 4 (July 1987), page 84.)
4. "Agents Urged To Check Stability Of Insurers", *National Underwriter*, (June 20, 1987, Page 20.)
5. "Agents Urged To Check Stability Of Insurers", *National Underwriter*, (June 20, 1987, Page 21.)

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